# Response to NCUA Advance Notice of Proposed Rule Making 12 CFR Part 704 – The Corporate Credit Union Network

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Altra
Federal Credit Union

Comment [91]:

**Altra Federal Credit Union**

# Table of Contents


| | |
|---|---|
| Opening Comment | **2** |
| 1. The Role of Corporates in the Credit Union System | **3** |
| 2. Corporate Capital | **8** |
| 3. Permissible Investments | **10** |
| 4. Credit Risk Management | **11** |
| 5. Asset Liability Management | **12** |
| 6. Corporate Governance | **13** |
| Closing Comment | **14** |

# Altra Federal Credit Union

**OPENING COMMENT**

Altra Federal Credit Union is honored to offer these comments and perspective in response to the NCUA Board's Advance Notice of Proposed Rule Making (ANPR) 12 CFR Part 704 on the Corporate Credit Union Network.

We have been working with Corporate Central Credit Union since 1977. I have also served on the Corporate Board since 2001. I am aware that in the 31 years we have been working with them, they have never had negative net income in any year and have never had a loss from a loan to a member. Their business model is one of serving their members for their sake – not for their own.

As both a Credit Union CEO and a Corporate CU board member, I feel very strongly that there are sufficient rules and regulations in place to provide the NCUA with the comfort of their oversight. Structure is another matter and is best served while an organization is evolving. I can only speak to Corporate Central Credit Union's culture and structure; and affirm it has evolved into exactly what the members needed and wanted from their corporate credit union.

While the NCUA may get greater comfort in redefining the structure and the roles corporate credit unions may play in the future – it will be the members who decide the course and direction.

As we have required more sophisticated products and services to meet the needs of our members (the consumers), Corporate Central Credit Union was called upon to be innovative and unique in their approach. While not wanting to spend entrusted capital to establish great amounts of infrastructure, they "partnered" with the best in class. . Capital was not sacrificed, and the members' needs were more than met. A good example of this is their partnership with Fiserv for item processing and check imaging. We are now able to offer our members on line check images and check image e-statements through our relationship with Corporate Central

This rudimentary approach to business has allowed Corporate Central Credit Union to build organically one of the highest capital ratios in the nation. The support we receive from our membership is unprecedented in the industry and it will be that same membership who will steer this corporate credit union in the direction they need.

It is from this framework that we offer the following comments on the issues presented for consideration.

**NOTE: Italicized text represents content from NCUA 12 CFR Part 704.**

## Altra Federal Credit Union

**1. THE ROLE OF CORPORATES IN THE CREDIT UNION SYSTEM**

*Recent events have highlighted structural vulnerabilities in the corporate credit union system. NCUA is considering whether comprehensive changes to the structure of the corporate system are warranted. Possible approaches the agency is considering include eliminating the second or wholesale tier from the corporate system, modifying the level of required capital, isolating payment services from the risks associated with other lines of business, determining which product and service offerings are appropriate for corporates, requiring a restructure of corporate boards, and tightening or eliminating the expanded investment authority that is currently available to corporates.*

**Corporate Credit Union Background**

Corporate credit unions continue to fulfill their traditional roles while evolving to meet the growing needs for a full range of financial, investment, credit, funds-transfer, settlement, and educational services by the credit union industry. Collaboration and partnerships between corporates of all sizes allows many services to be developed in a cooperative, low-cost/high value manner that ultimately saves credit unions money.

Corporate credit unions collectively process and settle more than 184 million transactions totaling more than $588 billion on a monthly basis for the credit union system in the form of: ACH, wire transfers, bill pay, item processing, and other payment-related services. In addition, corporates add value to the credit union system through their brokerage services, ALM and risk management services, member business services, and a number of other services that have been created from the needs of natural person credit unions and their members.

These products and services are in addition to the multiple investment options, settlement, and lending services that are at the core of every corporate's business model. As a natural person credit union, we depend on corporate credit unions for competitive rates and a full range of financial services. The 90 million Americans who use credit unions benefit from the synergy of the Corporate Network through increased back-office efficiencies, financial safety and soundness, efficient and cooperatively priced payment services.

The cooperative credit union tradition revolves around societal responsibility. The credit union movement has influenced the financial industry in ways that benefit members and non-members alike by providing low-cost financial services, competitive deposit and loan rates, and financial education.

# Altra Federal Credit Union

**NCUA ANPR Topic—Payment System**

*Some of the questions and issues arising in this context, on which the Board is seeking comment, include matters such as whether payment system services should be isolated from other services to separate the risks. If so, what is the best structure for isolating these services from other business risks? Specific comment is solicited concerning whether, for example, it would be better to establish a charter for corporate credit unions whereby a corporate's authority is strictly limited to operating a payment system, with no authority to engage in other services, such as term or structured investments. Additionally, a separate charter may be available for corporate credit unions that want to engage in providing investment services. Another alternative would be for NCUA to establish distinct capital requirements for payment systems risk and the risks of other corporate services. NCUA could also require that a legal and operational firewall be established between payment system services and other services. In connection with this topic, comment is also sought on the question of whether there is sufficient earnings potential in offering payment systems to support a limited business model that is restricted to payment systems services only.*

**Altra Federal Credit Union Comment—Payment System**

While Corporate Central provides a full array of payment system services, the risk portion has already been separated. There exists sufficient oversight to further mitigate risk for the processing of said payments. While one could argue the process and oversight can be expanded and improved, there does not seem to be a necessity to actually split a corporate into two distinct entities to accomplish it. To structure separate charters would cause undue costs so as to weaken an already efficient system.

We have a similar structure in our credit union.. Payments are processed every day without regard to the decisions made on either their investment or lending side. If one would think a "firewall," as you have stated, would be efficient and/or necessary in a corporate credit union – one could apply the same analogy on the natural person side. It's just not needed.

Risks are evaluated on a daily basis in every aspect of a corporate credit union's operation – just as in a natural person credit union. Risks are measured, mitigated, and taken. The strength of a credit union to remain viable is based on making good decisions instead of bad decisions, and there is no way to regulate that.

# Altra Federal Credit Union

**NCUA ANPR Topic—Liquidity and Liquidity Management**

*Historically, the primary role of corporate credit unions has been to provide and ensure liquidity. Corporate investments were made with an eye towards ensuring funds would be available to meet members' short-term liquidity needs. Recent events underscore the need to assure a corporate properly considers its investment position relative to its cash flow needs. The Board recognizes and understands that providing liquidity for the credit union system is one of the principal purposes of the corporate credit union network. One question for consideration and comment is whether liquidity ought to be considered a core service of the corporate system, and if so, what steps should be taken, and by whom, to preserve and strengthen corporates' ability to offer that service? For example, should NCUA consider limiting a corporate's ability to offer other specific types of products and services in order to preserve and defend the liquidity function? What specific types of products and services should corporates be authorized to provide? NCUA is considering additional cash flow measuring requirements to assist corporates in achieving and maintaining proper liquidity management. In this respect, comment is specifically solicited on the question of whether NCUA should add aggregate cash flow duration limitations to Part 704. If so, commenters are invited to describe how this requirement should be structured, and also to identify how such limitations would benefit liquidity management. Finally, comment is solicited on the question of what cash flow duration limits would be appropriate for corporate credit unions, particularly in an evolving interest rate market with previously unseen credit risk spreads.*

**Altra Federal Credit Union Comment—Liquidity and Liquidity Management**

Providing liquidity has been and will be a core service for corporate credit unions. Analyzing cash flow trends from an historical perspective is essential to determining liquidity needs. As a Corporate Board member, I am aware that rules currently in effect require us to perform this analysis and "shock" it semi-annually to measure impairment. If cash flow aggregators are implemented it may add some value to liquidity management; however, discipline is still required on the other side of the equation in order to accomplish this.

In this tumultuous economic climate many models are no longer appropriate. To place specific restrictions on cash flow durations in light of these times would be difficult and may prove to be useless or possibly harmful.

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**NCUA ANPR Topic—Field of Membership Issues**

*NCUA also seeks comment on whether and how to restructure the corporate credit union system. For example, despite its intention of fostering competition, NCUA's decision to allow corporates to have national fields of membership (FOMs) may have resulted in significant, and unforeseen, risk taking. For example, corporates have competed with each other to offer higher rates, and have done so through the accretion of credit and marketability risks. To address this development, should the agency return to defined FOMs, for example, state or regional FOMs?*

**Altra Federal Credit Union Comment—Fields of Membership Issues**

Fields of membership did not cause the current stress that exists within the corporate credit union system. In fact, for Corporate Central the ability to expand outside of Wisconsin has only made them stronger. Basic fundamentals and principles of business still apply.

**NCUA ANPR Topic—Expanded Investment Authority**

*At present, Part 704 provides for an option by which corporates meeting certain criteria can qualify for expanded investment authority. For example, a corporate meeting the criteria set out under Part One of the expanded authority is allowed to purchase investments with relatively lower credit ratings than otherwise permissible under the rule. NCUA seeks comment, first, as to whether the need for expanded authorities continues to exist. If so, should NCUA modify the procedures and qualifications, such as higher capital standards, by which corporates currently qualify for expanded authorities? If so, what should the new standards be? Should NCUA reduce the expanded authorities available? If so, which ones? Alternatively, should any of the limits in existing expanded authorities be reduced or increased? If so, which ones? Once granted, should NCUA require periodic requalification for expanded authorities? If so, what should be the timeframe?*

**Altra Federal Credit Union Comment—Expanded Investment Authority**

Part 704 that deals with expanded authority is well written and well structured. The oversight that currently exists at NCUA to review and grant expanded authority seems to work well. The oversight that should be in place "after" authority is granted may need some attention. Beyond that particular oversight, the undue risk associated with the decisions to seek higher yields through greater risk – may need to be re-thought. However, that rests with the corporate credit unions respective board and the mission it has set for the organization.

Higher capital standards for the various levels of expanded authority are a good approach. Capital levels may need to be evaluated in all forms of what one would consider "expanded authority." Re-certification of any level of expanded authority would be a good approach.

# Altra Federal Credit Union

**NCUA ANPR Topic—Structure; Two-Tiered System**

*Over time, the corporate system has evolved into two tiers: a retail network of corporates that provide products and services to natural person credit unions, and a single, wholesale corporate that exclusively services the retail corporates. NCUA solicits comment about whether the two-tier corporate system in its current form meets the needs of credit unions. Specifically, NCUA seeks input from commenters about whether there is a continuing need for a wholesale corporate credit union. If so, what should be its primary role? Should there be a differentiation in powers and authorities between retail and wholesale corporates? In considering these issues, commenters are specifically asked to consider whether the current configuration results in the inappropriate transfer of risk from the retail corporates to the wholesale corporate. Commenters should also address whether, assuming the two-tiered system is retained, capital requirements and risk measurement criteria (e.g., NEV volatility), as well as the range of permissible investments, for the wholesale corporate credit union should be different from those requirements that apply to a retail corporate credit union.*

**Altra Federal Credit Union Comment—Structure; Two-Tiered System**

There is definitely a need for a wholesale corporate credit union. We need an organization that is looking out for us and our needs. Our previous relationships with banks were never a partnership where both parties had the same interests. The original purpose was a good one. Change in structure of the wholesale corporate needs to be accomplished not the official removal of it.

The primary roles should be one of aggregation for the purposes of short-term liquidity and a funding source. Differentiation of powers is not necessary. Governance and oversight will accomplish the stated purpose. The entire aspect of capital sufficient to risk needs to be addressed. The greater the risk – the greater the capital requirement. The parameters to measure risk are already in place. It appears the adherence to those parameters must be addressed.

# Altra Federal Credit Union

**2. CORPORATE CAPITAL**

*NCUA is considering revising various definitions and standards for determining appropriate capital requirements for corporate credit unions. For example, the agency could establish a new required capital ratio consisting only of core capital excluding membership capital accounts as a component of regulatory capital; the agency could also determine to increase the required capital ratio to more than four percent. The agency could also establish a new ratio based on risk-weighted asset classifications, which could include some form of membership capital. These changes would bring the corporate capital requirements more into line with standards applied by other federal financial regulators, such as the Comptroller of the Currency and the Federal Deposit Insurance Corporation (recognizing, however, that there are other accounting differences that apply with respect to the calculation of regulatory capital for banks). Another issue under consideration is whether to require a certain level of contributed capital from any natural person credit union seeking either membership or services from a corporate.*

**NCUA ANPR Topic—Core Capital**

*The Board is considering several issues relating to the agency's approach to core capital (i.e., the traditional "tier one capital" definition as used by the several federal financial institution regulators). Under the current rule, core capital is defined as retained earnings plus paid-in capital. CFR 704.2. Comment is invited concerning whether NCUA should establish a new capital ratio that corporates must meet consisting only of core capital, and if so, what would be the appropriate level to require. Commenters should offer their view concerning what actions are necessary to enable corporates to attain a sufficient core capital ratio as described above, as well as their thought about what would be an appropriate time frame for corporates to attain sufficient capital. The Board invites comment also on the question of what is the appropriate method to measure core capital given the significant fluctuation in corporate assets that occur. Commenters are invited to offer their view on the correct degree of emphasis that ought to be placed on generating core capital through undivided earnings. Finally, NCUA Is considering whether to require that a corporate limit its services only to members maintaining contributed core capital with the corporate. Commenters are invited to react to that idea, and to offer any other suggestions or comments relative to the issue of core capital for corporates.*

**Altra Federal Credit Union Comment—Core Capital**

Core capital is vital to a corporate credit union. Not only for the purpose of taking on risk, but it speaks to the support of its members. If core capital consists solely of RUDE it makes one statement. If it exists of RUDE and PIC – it makes a different statement. The support members give a corporate is not only based on dollars but in actions. While there is no quantifiable way to assess the latter, we are stuck with the former. To that end core capital should be raised to four percent. This would consist of both RUDE and PIC. It would be very difficult at this point to place parameters solely on RUDE. Once PIC was introduced as an alternative form of core capital – the Corporates lost any requirement to be placed on levels of RUDE forever. Since the voluntary guarantee on deposits at corporate credit unions is set to expire on December 31, 2010 – that would appear to be a sufficient timeframe to accomplish four percent.

# Altra Federal Credit Union

**NCUA ANPR Topic—Membership Capital**

*The Board is also considering several issues involving membership capital. 12 CFR 704.3(b). Issues under consideration and for which comment is sought include whether NCUA should continue to allow membership capital in its current configuration, or should the agency eliminate or modify certain features, such as the adjustment feature, so that membership capital meets the traditionally accepted definition of tier two capital. Other questions include whether to tie adjusted balance requirements, as set out currently in §704.3(b)(8), only to assets, as well as whether to impose limits on the frequency of adjustments. The agency is considering whether to require that any attempted reduction in membership capital based on downward adjustment automatically result in the account being placed on notice, within the meaning of current §704.3(b)(3), so that only a delayed payout after the three-year notice expires is permissible. Comment is also sought on whether to require that any withdrawal of membership capital be conditioned on the corporate's ability to meet all applicable capital requirements following withdrawal. Comment is invited on all these issues and on any revisions NCUA should consider for the definition and operation of membership capital.*

**Altra Federal Credit Union Comment—Membership Capital**

Membership capital has served us well. Corporate credit unions now need to focus on core capital. If the percentage minimums for core capital are raised – it virtually eliminates the need for membership capital. If membership capital is allowed to be treated in a manner to satisfy regulatory requirements the terms surrounding it are sufficient. This would include the notice, the adjustments – either downward or upward, and the delayed payout. No changes are then necessary.

**NCUA ANPR Topic—Risk-Based Capital and Contributed Capital Requirements**

*Comment is solicited with respect to the following issues pertaining to risk-based capital and contributed capital requirements. Should NCUA consider risk-based capital for corporates consistent with that currently required of other federally regulated financial institutions? What regulatory and statutory changes, if any, would be required to effectuate such a change? Should a natural person credit union be required to maintain a contributed capital account with its corporate as a prerequisite to obtaining services from the corporate? Should contributed capital be calculated as a function of share balances maintained with the corporate? What about using asset size?*

**Altra Federal Credit Union Comment— Risk-Based Capital and Contributed Capital Requirements**

Capital in the form of Membership Capital Accounts has served a very useful purpose. This showed our commitment to our corporate credit union and also afforded benefits beyond a rate. The leverage of that capital to provide core services and innovative products has served the industry well. While they currently use a percent of assets to establish membership capital levels, other calculations could be determined by that corporate credit union's respective board which reflects its membership. One size will not always fit everyone.

# Altra Federal Credit Union

**3. PERMISSIBLE INVESTMENTS**

*NCUA is considering whether the corporate investment authorities should be constrained or restricted. Presently, corporates have the authority to purchase and hold investments that would not be permissible for natural person FCU members under Part 703 (or, in some cases, outside of what is authorized for a state chartered credit union). This increases a corporate member's exposure to these risks commensurate with their level of investment in the corporate. Questions on which comment is solicited in this context include whether NCUA should limit corporate credit union investment authorities to those allowed for natural person credit unions. NCUA is also considering whether to prohibit certain categories of, or specific, investments, for example: collateralized debt obligations (CDOs), net interest margin securities (NIMs), and subprime and Alt-A asset-backed securities. Comment is solicited on that issue, as well as on whether NCUA should modify existing permissibility or prohibitions for investments.*

**Altra Federal Credit Union Comment**

. The ability to purchase, sell, and hold marketable investments has served the industry well. There are many models that exist today whereby the corporate credit union prudently managed this risk. While some would say this caused much of the trouble – we disagree. Structure and discipline – or the lack thereof – caused this problem. There are some investments in hindsight that should not have been purchased – to eliminate them altogether would be a mistake. Greater pre-purchase scrutiny coupled with proper oversight would accomplish necessary levels of comfort and compliance.

## Altra Federal Credit Union

**4. CREDIT RISK MANAGEMENT**

*The reliability of credit ratings for investments has become more questionable in light of events in the financial industry and the current absence of regulatory oversight for rating organizations. Consequently, NCUA is considering curbing the extent to which a corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs). Comment is requested on whether NCUA should require more than one rating for an investment, or require that the lowest rating meet the minimum rating requirements of Part*

*704. NCUA also solicits comment on whether to require additional stress modeling tools in the regulation to enhance credit risk management. Several specific aspects of this issue are under consideration, for which comment is solicited, including whether Part 704 should be revised to lessen the reliance on NRSRO ratings. Commenters are invited to identify any other changes they believe may be prudent to help assure adequate management of credit risk. In this respect, commenters should consider whether Part 704 should be revised to provide specific concentration limits, including sector and obligor limits. If so, what specific limits would be appropriate for corporate credit unions? Comments are also solicited on the question of whether corporates should be required to obtain independent evaluations of credit risk in their investment portfolios. If so, what would be appropriate standards for these contractors? Another issue under consideration is whether corporates should be required to test sensitivities to credit spread widening, and if so, what standards should apply to that effort.*

**Altra Federal Credit Union Comment**

A corporate credit union – or for that matter – any entity – should use all of the tools at their disposal to analyze purchases. If the tools exist to perform more analytics pre and post purchase they should be sought out and utilized. If variances exist on the ratings garnered from more than one source – the lower of the two would be quite acceptable. Independent evaluations are quality tools that any organization should utilize to evaluate their investment portfolios. It appears a regulation to that effect may be needed.

The appropriateness for contractors is one of great concern. It appears standards of methodology do not exist within the market and thus each contractor has a different approach. If standards within that industry could be achieved it would be a more valuable tool.

# Altra Federal Credit Union

**5. ASSET LIABILITY MANAGEMENT**

*In a previous version of its corporate rule, NCUA required corporate credit unions to perform net interest income modeling and stress testing. Because one of the problems leading to the current market dislocation is a widening of credit spreads, the agency is considering reinstating this requirement. Alternatively, the agency may consider some form of mandatory modeling and testing of credit spread increases. Comment is solicited on whether NCUA should require corporates to use monitoring tools to identify these types of trends, including specifically comments about tangible benefits, if any, that would flow from these types of modeling requirements.*

**Altra Federal Credit Union Comment**

Net interest income modeling and stress testing is appropriate for corporates with expanded investment authorities. Credit spreads were not a leading cause of the current market dislocation, they occurred after the initial crisis as a symptom. The cause of the market dislocation was failure to abide by prudent common sense by some corporates, and others in the financial world. The corporate system has a number of existing monitoring tools that just need to be used appropriately. Corporates with expanded investment authorities need to be properly monitored to make sure they are following their modeling and stress testing procedures.

# Altra Federal Credit Union

**6. CORPORATE GOVERNANCE**

*The sophistication and far-reaching impact of corporate activities requires a governing board with appropriate knowledge and expertise. NCUA is considering minimum standards for directors that would require a director possess an appropriate level of experience and independence. The agency is also considering term limits, allowing compensation for corporate directors, and requiring greater transparency for executive compensation. Comment is sought on all these issues. In addition, commenters are invited to respond to the question of whether or not the current structure of retail and wholesale corporate credit union boards is appropriate given the corporate business model. Should NCUA establish more stringent minimum qualifications and training requirements for individuals serving as corporate credit union directors? If so, what should the minimum qualifications be? NCUA is also considering whether to establish a category of "outside director," i.e., persons who are not officers of that corporate, officers of member natural person credit unions, and/or individuals from entirely outside the credit union industry. Commenters should offer their view on whether that approach is wise, and, if so whether NCUA should require that corporates select some minimum number of outside directors for their boards. Should a wholesale corporate credit union be required to have some directors from natural person credit unions? Comment is sought on whether NCUA should impose term limits on corporate directors, and, if so, what the maximum term should be. Comment is also sought on whether corporate directors should be compensated, and, if so, whether such compensation should be limited to outside directors only. Another issue under consideration, for which reaction from commenters is sought, is whether NCUA should allow members of corporate credit unions greater access to salary and benefit information for senior management.*

**Altra Federal Credit Union Comment**

The members elect, from amongst their peers, directors to set course and direction for their credit union; albeit a corporate credit union. To rule someone out based on their "appropriate" level of experience or expertise would be difficult to say the least. To allow director compensation would be a step in the right direction. As far as transparency – all state chartered corporate credit unions are already required to file a 990 which includes officer compensation.

Credit unions were founded on the principles of electing directors from amongst their members. To bring in outside directors – for that purpose – would be a bad decision. It would certainly erode the principles upon which our movement was founded. There should be NO outside directors. Members should elect directors from amongst their peers. It's simple and basic. It works - don't change it. If a credit union wants to compensate their directors – let them.

If you want transparency, do so at the board level. In this current environment, transparency is needed more than ever. That goes for everyone!

As mentioned before – state chartered credit unions are already required to disclose senior management compensation.

# Altra Federal Credit Union

**CLOSING COMMENT**

It appears that most of the issues came down to stewardship, principled discipline, and proper management of the credit union resources entrusted to the Corporate Credit Union Network. There are areas needing attention and oversight, but wholesale changes are not required. The role of a corporate is well defined today, and members will continue to refine that definition as their needs change.

We feel that Corporate Central Credit Union's business model works – period. A model founded on the credit union philosophy and reinforced by our committed members.

Altra Federal Credit Union appreciates the opportunity to provide comment and encourages all of our members to take part in this important process. We support NCUA's effort to stabilize the Corporate Credit Union Network and look forward to actively working together to improve the network for the betterment of all credit unions and the entire credit union movement.